

Strengthening the Municipal Bond Market

Ostrów Wielkopolski, Poland

Background

Like many other local governments in Eastern Europe, cities in Poland have inherited the responsibility for severely deteriorated and inefficient infrastructure systems. Because of economic reforms in the early 1990s, cities recognized that subsidized credits from the national or regional government for infrastructure maintenance and repair would not be adequate to meet local infrastructure demand. Similarly, a review of the local financial resources revealed that the accumulation of current revenues would not be able to cover the high cost of building, buying, or replacing capital assets in immediate need of replacement. To substantially increase investment in municipal infrastructure, the national government of Poland adopted a strategy to stimulate long-term debt financing by creditworthy municipalities using modern municipal infrastructure financing techniques. The City of Ostrów Wielkopolski (population 75,000) was chosen to test the experience of issuing municipal bonds to fund a capital improvement project.

Innovation

In June 1995, the national government enacted the new Bonds Act to provide a better regulatory environment for market growth. In July 1995, the Municipal Development Agency (MDA) conducted a Municipal Bonds Roundtable Discussion to identify critical constraints to implementing a Municipal Bonds Market in Poland. The roundtable was attended by senior government policy-makers (MDA, Ministry of Finance, Securities Commission), potential institutional investors (insurance companies, investment funds, banks, international donors), and service providers (underwriters, brokers, dealers). The participants identified the lack of Disclosure Guidelines as a critical problem to trading municipal bonds publicly either through initial placement on the Warsaw Exchange or through secondary trading on the new over-the-counter market. Municipal bonds had to be publicly tradeable on the secondary market to give them the liquidity demanded by many potential investors, or the market as a substantial source of municipal infrastructure financing would be severely limited. The Securities Commission subsequently prepared draft Disclosure Guidelines and tested them in the city of Ostrów Wielkopolski. These Guidelines set the disclosure requirements to be met by municipal bond issuers wishing to have their securities traded publicly.

Ostrów Wielkopolski performed a financial analysis to determine its creditworthiness for issuance of municipal bonds. The analysis indicated a need for more rigorous capital investment programming of the projected surplus available for investment. These findings convinced the City Council to use long-term debt financing for its roads improvement project. Ostrów Wielkopolski prepared a Model Prospectus (to be required for primary public offering) and a Model Information Memorandum (to be required for admission to secondary trading). In April 1996, the city issued a 7.5 million PLN (new Polish złoty) bond for road improvements through a private placement.

Results

The Council of Ministers approved an ordinance on Municipal Bond Disclosure on October 10, 1996. The Information Memorandum, which will allow Ostrów Wielkopolski's bonds to be publicly traded on the over-the-counter market, has been prepared and is expected to be approved before the end of the year. Public trading of municipal bonds will substantially broaden the base of potential investors in municipal bonds and increase the access of municipalities to long-term funds at competitive rates.

Summary

To substantially increase investment in municipal infrastructure, the national government of Poland adopted a strategy to stimulate long-term debt financing by creditworthy municipalities. The strategy was tested in the City of Ostrów Wielkopolski, which prepared a Model Prospectus and a Model Information Memorandum and, in April 1996, issued municipal bonds for road improvements.

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